BRIEF IN SUPPORT OF THE PETITION.

Argument.

POINT I.

An account receivable arising in the ordinary course of business is not a capital asset within the meaning of Section 117 of the Revenue Act of 1936.

Section 117 (b) of the Revenue of 1936 defines capital assets as follows:

> "For the purposes of this title, 'capital assets' means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of the kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business"

and the Treasury Regulations promulgated under that Act further define the term "capital assets" as follows:

> "The term 'capital assets' includes all classes of property not specifically excluded by Section 117 (b) * * *" (Art. 117-1).

Superficially it would appear that accounts receivable would be capital assets under this definition of the statute and the regulations and the Circuit Court

of Appeals in the instant case so assumes. However, isolated words or phrases cannot be picked out of their context to determine the meanings of statutes, or for that matter constitutional amendments, but the entire statute or constitutional amendment must be interpreted as a whole and in respect to the underlying fault which was intended to be corrected. Thus the apparently unrestricted taxing power granted to the Federal Government by the Sixteenth Amendment to the Constitution was interpreted in the case of *Brushaber* v. *Union Pacific Railroad Company,* 240 U. S. 1, merely as the exclusion of the source from which a taxed income was derived as the criterion in determining its constitutionality, thus merely overcoming the previous constitutional inhibition contained in the case of *Pollock* v. *Farmers Loan & Trust Co.,* 157 U. S. 429, but not otherwise extending the Federal tax power. Likewise, in the instant case the definition of capital assets and a limitation on capital losses must be considered in connection with the evil sought to be eliminated.

The limitation on capital losses was first contained in the Revenue Act of 1934 the purpose being to safeguard the loss of revenues caused by deducting capital losses, which were mostly paper losses, from net income. This is well illustrated by discussion of this provision of the Act on the floor of the House where Representative Samuel B. Hill, for the House Ways and Means Committee, explained the situation as follows:

> "The Committee feels it has absolutely plugged that avenue from which taxes were escaping by manipulation of capital investments purely for the purpose of creating paper losses in order that

> they might offset those losses against ordinary income and thereby reduce the taxes of the taxpaper" (Congressional Record, Vol. 78, p. 2663).

The important thing to notice here is that Congress was dealing with investments and not with ordinary debts arising in the course of business.

The very nature of an account receivable makes these sections of the tax law inapplicable to them. Since there is no fluctuation in its market value, which is unrelated to its real value, any depreciation in value is immediately a real loss in contra-distinction to an investment which may fluctuate in its market value without any relationship to its real value. This section of the law is intended to apply to that type of property which fluctuates in its market value without any relationship to its real value, thus enabling a taxpayer to take a loss which is purely a paper loss, being able to repurchase his investment at a later period. On the other hand, an account receivable is a distinctive asset which cannot be speculated in and whose decline in value is caused only by a real loss of value which is presently deductible by a taxpayer under the bad debt provisions of the law.

Because of these clear and obvious distinctions between investments and accounts receivable and because the evil sought to be corrected by Section 117 (b) and (d) of the 1936 Act arose only in connection with investments, an account receivable is not a capital asset within the meaning of Section 117 despite its broad definition.

POINT II.

Capital loss provisions of the Revenue Act of 1936 do not apply to bad debts.

Assuming for the sake of argument that an account receivable is a capital asset within the meaning of Section 117 of the Revenue Act of 1936, nevertheless, the capital loss limitations of that Act do not apply to a bad debt. This Court has held that the deductions for bad debts and for losses are mutually exclusive and that a deduction under one is not affected by the provisions of the other. *Lewellyn* v. *Electric Reduction Co.*, 275 U. S. 243; *Spring City Foundry Company* v. *Commissioner*, 292 U. S. 182. In the latter case, the Court explains the reason for its ruling as follows:

> "The making of the specific provision as to debts indicates that these were to be considered as a special class and that losses on debts were not to be regarded as falling under the preceding general provision."

Thus, this Court has construed the bad debt deduction to be a special loss deduction carved out from the general loss deduction and to be governed independently by its own rules *sui generis* and not to be limited by any provision of the loss deduction.

While these cases are concerned only with the distinction between the loss deduction and bad debt deduction, the principles enunciated therein are equally applicable to the capital loss provisions since these were intended as further limitations on losses and were not intended as limitations on bad debt deductions. The position of these provisions of the law

in the 1936 Revenue Act further confirms this point. In Section 23, the general deduction section, losses of individuals are governed by subdivision E, and of corporations by subdivision F. Sub-sections G, H, I and J are limitations on the general loss provisions respectively governing wagering losses, the basis for determining loss, wash sale losses and capital losses. After these loss sub-sections are completed, there comes sub-section K which deals with bad debt deductions and is clearly not modified by any provisions of the preceding loss deduction sub-sections.

Since the opinion of the Court below agrees that the debt in question became partially worthless in 1937, and also that the charge-off requirements of Section 23 (k) of the 1936 Revenue Act were complied with, the petitioner's claimed bad debt deduction must be allowed without any regard to the capital loss provisions of the tax law.

POINT III.

A charge-off on the books of a partial bad debt need not be made simultaneously with the ascertainment of partial worthlessness but can be made at any time within the taxable year.

The lower Court in the instant case has ruled against the taxpayer on the theory that although he had properly ascertained his account receivable to be partially worthless prior to his sale of it, the sale before his charge-off of the partial bad debt on his books left nothing to be charged off, so that there was not proper compliance with the bad debt provisions of the tax statute. The Court thus erroneously assumes that the charge-off for a partial bad

debt must be made simultaneously with the ascertainment of partial worthlessness and cannot be made during the taxable year. The law on the subject does not so provide, merely limiting the portion of a bad debt deductible as a partial bad debt to that part charged off within the taxable year. This is not a limitation by way of time but by way of amount and there is no indication that the treatment of partial bad debts, as far as the charge-off requirement is concerned, is any different from that of the treatment of totally worthless debts.

On the subject of totally worthless debts, the First and Seventh Circuit Courts of Appeals are in agreement that a charge-off at any time within a taxable year or even after the end of the taxable year, if made as of the end of the taxable year, is sufficient. *Hamlen* v. *Welch*, 116 Fed. (2d) 413, First Circuit; *Commissioner* v. *MacDonald Engineering Co.*, 102 Fed. (2d) 942, Seventh Circuit; *Rubinkam* v. *Commissioner*, 118 Fed. (2d) 148, Seventh Circuit.

In *Hamlen* v. *Welch*, *supra*, the Court explains the charge-off as follows:

> "It is not the physical act done within the year to which Congress has referred, but to the setting up of evidence as to the ascertainment of worthlessness substantially as of the date of such ascertainment and confirmation thereof."

In the *Rubinkam* case, *supra*, the charge-off was actually made in February of the year following the taxable year in which the loss was claimed and this was held to comply with the statutory requirements. Thus, in the First and Seventh Circuits, as well as

in innumerable Tax Court cases, the charge-off requirement for bad debt deductions is regarded as merely confirmative of the ascertainment of worthlessness and can be made at any time within the taxable year or as of the end of the taxable year. Since the petitioner herein has met this test and the opinion of the lower court so concedes ("it is also clear that the taxpayer literally complied with the language of the statute in that he actually made the charge-off within the taxable period for which he claimed the deduction"), the partial bad debt loss was effective prior to the sale of the underlying account receivable and its sale should have no effect on the tax consequences of the partial bad debt loss but is merely confirmatory of the value of that partial bad debt loss.

Conclusion.

In view of the conflict of the decision of the Court below with various decisions of this Court and the other Circuits, and because of the widespread effect of the principles involved, to wit, the proper delineation of the bad debt, loss and capital loss-deductions, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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